OPEN MEETING

MEMORANDUM

TO: THE COMMISSION

FROM: Utilities Division

DATE: July 7, 2010

RE: TUCSON ELECTRIC POWER COMPANY - APPLICATION FOR APPROVAL OF ITS REQUEST FOR ADDITIONAL FUNDING FOR ITS NON-RESIDENTIAL EXISTING FACILITIES PROGRAM (DOCKET NO. E-01933A-07-0401)

On January 15, 2010, Tucson Electric Power Company ("TEP" or "the Company") filed an application requesting that the Commission approve an increase in funding for the Company's Existing Facilities ("Existing Facilities") Demand-Side Management ("DSM") program for 2010 through 2012. The purpose of the requested budget increase is to accommodate unexpectedly high participation levels for this non-residential program.

The Company reports that, by December 31, 2009, TEP paid $746,000 in incentives, almost exhausting the combined 2008 and 2009 incentive budget of $775,866.[1] Given this rate of participation, TEP believes that, without an increase, the program would exhaust its budget before the end of its 2010 program year.

Program Description. The Existing Facilities program targets Non-Residential customers on Rates 13 and 14, usually with an aggregate demand of 200 kW or more. The program promotes the installation of energy efficient lighting; heating, ventilating and air conditioning equipment ("HVAC"); motors; motor drives; compressed air and refrigeration.

Scope of Review; Compliance. Decision No. 70403 originally approved the Existing Facilities program, but ordered that the HVAC portion of the Existing Facilities program be treated as a pilot, due to insufficient data on the HVAC measures' cost-effectiveness. TEP was ordered to provide updated local price, size and efficiency information on HVAC equipment no later than September 30, 2009, so that the cost-effectiveness of these measures could be properly assessed.

In accordance with Decision No. 70403, TEP filed the required information, and included updated information on energy savings. TEP also provided data respecting Non-residential HVAC equipment of less than 5.4 tons, having determined during the course of the program that there was a market for the smaller tonnage HVAC units among potential non-residential program participants.

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[1] The program was launched in October 2008, so little of the 2008 incentive budget was expended. The Company allowed the Implementation Contractor to use the combined total incentive dollars for 2008 and 2009.

Program spending is likely to be impacted by the number and type of measures eligible for incentives, and it is Staff's position that, to be eligible, a DSM measure must be cost-effective. In order to have a more complete understanding of the program's budget needs, Staff has analyzed the cost-effectiveness of the HVAC measures, to ascertain whether they should be eligible for incentives and taken into account when considering the proposed budget increase. To perform the analysis, Staff utilized the updated data in incremental costs and energy savings from the compliance filing.

In order to be cost-effective, the benefit-cost ratio of a measure must be at least 1.0, (although, under the Societal Cost Test used by Staff, non-monetized environmental benefits are taken into account for measures close to 1.0). Staff's analysis indicates that the HVAC measures are cost-effective, even without taking environmental benefits into account, and should remain eligible for incentives as part of the Existing Facilities program. The cost-effectiveness of the HVAC measures, both air conditioners and heat pumps, are listed in the table below, by tonnage.

Non-residential Split and Packaged Air Conditioners	
Unit Type (Size)	Benefit-Cost Ratios
Less Than 5.4 Tons	1.02
5.4 to 11.25 Tons	1.11
11.25 to 20 Tons	1.82
More than 20 Tons	1.33
Non-residential Split and Packaged Heat Pumps	
Unit Type (Size)	Benefit-Cost Ratios
Less Than 5.4 Tons	1.12
5.4 to 11.25 Tons	1.18
11.25 to 20 Tons	1.97
More than 20 Tons	1.01

Staff recommends that the HVAC measures continue to be eligible for incentives as part of the Non-Residential Existing Facilities program.

Budgets: Existing and Proposed. Below is a table showing the proposed increases, by category[2]:

Budget Categories	**Current 2010 Budget**	**Requested 2010-2012 Budget[3]**
Administrative	Current 2010	Requested 2010
Internal Utility Managerial and Clerical	$29,636	$84,472

[2] A detailed breakdown of the existing and proposed budgets was provided by TEP in response to an inquiry from Staff.

[3] Although percentage allocations would remain constant, actual dollar amounts may adjust by up to 3% per year, primarily due to inflation.

Travel and Direct Expenses	$4,448	$12,677
Overhead	$2,979	$8,490
Total Administrative Cost	**$37,062**	**$105,639**
Marketing	Current 2010	Requested 2010
Internal and Subcontracted Marketing Expense	$31,575	$90,000
Total Marketing Cost	**$31,575**	**$90,000**
Implementation	Current 2010	Requested 2010
Incentives	$445,578	$1,270,041
Implementation Contractor Services	$192,961	$550,000
Hardware and Materials	$15,437	$44,000
Total Implementation Cost	**$653,975**	**$1,864,041**
Evaluation, Measurement and Verification ("EM&V")	Current 2010	Requested 2010
EM&V Activity	$15,788	$45,000
EM&V Overhead	$4,229	$12,055
Total EM&V Cost	**$20,017**	**$57,055**
Total Program Cost	**$742,631**	**$2,116,735**

Allocations to the IC. Staff expressed concern about the amount ($550,000) allocated to the Implementation Contractor ("IC"). In communications with Staff, TEP explained that its initial estimate was low and that it originally intended to run its non-residential portfolio in-house, but determined that it did not have the resources or experience to implement complex, comprehensive non-residential programs. Using a competitive bidding process, the Company hired an IC and re-allocated most of the in-house administrative budget originally intended for TEP to the IC, reflecting the shift of responsibilities to the IC.

TEP stated that the contractor uses locally hired employees, and that their duties include marketing, contractor recruitment, contractor training, customer outreach, applications processing, pre- and post-inspection of customers' facilities, engineering services to assess customer incentive applications, rebate processing, reporting to TEP, and internal administration of the program. The full-time employees include an engineer hired to evaluate customers' systems for the Existing Facilities[4] program (due to the highly technical nature of systems for the larger commercial or industrial customers). In addition, the IC provides a call center for questions from trade allies and customers, coordination with the Measurement, Evaluation and Research ("MER") contractor, communications with manufacturers and distributors, monitoring of supplies of qualifying products and tracking of manufacturer's plans for developing qualifying products.

Staff Analysis and Recommendations. The increased budget requested for the IC is proportionate to the increases requested for other budget categories, including incentives. Moreover, the program has unusually complex technological requirements and is experiencing high levels of participation. Nonetheless, Staff remains concerned at the amount allocated to the

[4] The engineer primarily works on the Existing Facilities program, but also provides technical support to the Small Business program on an as-needed basis.

IC, and the absence of an existing cap. The IC is allocated 26 percent of the total program costs in both the existing 2010 budget and proposed 2010-2012 budgets.[5] Staff notes that the program was launched in late 2008, and that, as a program is ramped up, some per-unit costs (such as marketing) should decrease over time. This should be reflected in the budget for the IC.

Staff recommends that the increase in the overall budget of the Existing Facilities program be approved, but that payments to the Implementation Contractor not exceed 21 percent of the Existing Facilities program budget, and that amounts over 21 percent of the total approved budget be shifted from the IC category to incentives. (This would mean that, in the budget table above, the budget amount under "Implementation Contractor Services" would be reduced from $550,000 to $444,514, and the budget amount under "Incentives" would be increased from $1,270,041 to $1,375,527.)

Bill Impacts. The requested budget increase, projected kWh sales, per-kWh increment and average summer and winter Residential bill annual impacts are listed below:

Budget Increase Amount	Projected kWh Sales (2009)	DSM Adjustor per-kWh increment	**Annual** Residential Impact, Based on average 10,707 kWh usage	**Annual** Commercial Impact, Based on average 55,757 kWh usage
$1,374,105	9,552,111,194	$0.000144	$1.54	$8.02

The bill impacts shown above reflect a full year of the proposed increase to the Existing Facilities program budget. The current DSM adjustor rate (which is not altered in this matter), was approved in Decision No. 71720 on June 3, 2010, and includes 80% of the proposed budget increase, based on the program's high participation rate since inception. (Any over- or under-collections relative to spending for the overall DSM portfolio will be taken into account and trued up during the next adjustor reset.)

Reporting Requirements. In addition to the existing reporting requirements, Staff recommends that TEP's semi-annual DSM reports, or any succeeding reports ordered by the Commission, include a section which lists how much is paid to the IC, by program and in total.

Summary of Recommendations.

- Staff recommends that TEP's request to increase the overall budget for its Existing Facilities program be approved.

[5] In 2009, 22.4% of total program spending went to Program Implementation, a category which includes direct program delivery costs, including implementation contractor labor and overhead costs. (See Table 2 of the semi-annual DSM report for TEP, for January through December 2009.)

- Staff recommends that the HVAC measures continue to be eligible for incentives as part of the Non-Residential Existing Facilities program.

- Staff recommends that payments to the IC not exceed 21 percent the Existing Facilities overall program budget.

- Staff recommends that TEP's semi-annual DSM reports, or any succeeding reports ordered by the Commission, include a section which lists how much is paid to the IC, by program, and in total.

Steven M. Olea
Director
Utilities Division

SMO:JMK:lhm\RM

ORIGINATOR: Julie McNeely-Kirwan

BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES
Chairman
GARY PIERCE
Commissioner
PAUL NEWMAN
Commissioner
SANDRA D. KENNEDY
Commissioner
BOB STUMP
Commissioner

IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER COMPANY FOR APPROVAL OF ITS REQUEST FOR ADDITIONAL FUNDING FOR ITS NON-RESIDENTIAL EXISTING FACILITIES PROGRAM	DOCKET NO. E-01933A-07-0401 DECISION NO. __________ ORDER

Open Meeting
July 27 and 28, 2010
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Tucson Electric Power Company ("TEP" or "the Company") is engaged in providing electric power within portions of Arizona, pursuant to authority granted by the Arizona Corporation Commission.

2. On January 15, 2010, TEP filed an application requesting that the Commission approve an increase in funding for the Company's Existing Facilities ("Existing Facilities") Demand-Side Management ("DSM") program for 2010 through 2012. The purpose of the requested increase is to accommodate unexpectedly high participation levels for this non-residential program.

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3. The Company reports that, by December 31, 2009, TEP paid $746,000 in incentives, almost exhausting the combined 2008 and 2009 incentive budget of $775,866.[1] Given this rate of participation, TEP believes that, without an increase, the program would exhaust its budget before the end of its 2010 program year.

4. *Program Description*. The Existing Facilities program targets Non-Residential customers on Rates 13 and 14, usually with an aggregate demand of 200 kW or more. The program promotes the installation of energy efficient lighting; heating, ventilating and air conditioning equipment ("HVAC"); motors; motor drives; compressed air and refrigeration.

5. *Scope of Review; Compliance*. Decision No. 70403 originally approved the Existing Facilities program, but ordered that the HVAC portion of the Existing Facilities program be treated as a pilot, due to insufficient data on the HVAC measures' cost-effectiveness. TEP was ordered to provide updated local price, size and efficiency information on HVAC equipment no later than September 30, 2009, so that the cost-effectiveness of these measures could be properly assessed.

6. In accordance with Decision No. 70403, TEP filed the required information, and included updated information on energy savings. TEP also provided data respecting Non-residential HVAC equipment of less than 5.4 tons, having determined during the course of the program that there was a market for the smaller tonnage HVAC units among potential non-residential program participants.

7. Program spending is likely to be impacted by the number and type of measures eligible for incentives, and it is Staff's position that, to be eligible, a DSM measure must be cost-effective. In order to have a more complete understanding of the program's budget needs, Staff has analyzed the cost-effectiveness of the HVAC measures, to ascertain whether they should be eligible for incentives and taken into account when considering the proposed budget increase. To perform the analysis, Staff utilized the updated data in incremental costs and energy savings from the compliance filing.

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[1] The program was launched in October 2008, so little of the 2008 incentive budget was expended. The Company allowed the Implementation Contractor to use the combined total incentive dollars for 2008 and 2009.

8. In order to be cost-effective, the benefit-cost ratio of a measure must be at least 1.0, (although, under the Societal Cost Test used by Staff, non-monetized environmental benefits are taken into account for measures close to 1.0). Staff's analysis indicates that the HVAC measures are cost-effective, even without taking environmental benefits into account, and should remain eligible for incentives as part of the Existing Facilities program. The cost-effectiveness of the HVAC measures, both air conditioners and heat pumps, are listed in the table below, by tonnage.

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11.25 to 20 Tons	1.97
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9. Staff has recommended that the HVAC measures continue to be eligible for incentives as part of the Existing Facilities program.

10. *Budgets: Existing and Proposed*. Below is a table showing the proposed increases, by category[2]:

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11. *Allocation to IC*. Staff expressed concern about the amount ($550,000) allocated to the Implementation Contractor ("IC"). In communications with Staff, TEP explained that its initial estimate was low and that it originally intended to run its non-residential portfolio in-house, but determined that it did not have the resources or experience to implement complex, comprehensive non-residential programs. Using a competitive bidding process, the Company hired an IC and re-allocated most of the in-house administrative budget originally intended for TEP to the IC, reflecting the shift of responsibilities to the IC.

12. TEP stated that the contractor uses locally hired employees, and that their duties include marketing, contractor recruitment, contractor training, customer outreach, applications processing, pre- and post-inspection of customers' facilities, engineering services to assess customer incentive applications, rebate processing, reporting to TEP, and internal administration of the program. The full-time employees include an engineer hired to evaluate customers' systems for the Existing Facilities program[4] (due to the highly technical nature of systems for the larger commercial or industrial customers). In addition, the IC provides a call center for questions from trade allies and customers, coordination with the Measurement, Evaluation and Research ("MER") contractor, communications with manufacturers and distributors, monitoring of supplies of qualifying products and tracking of manufacturer's plans for developing qualifying products.

13. *Staff Analysis and Recommendations*. The increased budget requested for the IC is proportionate to the increases requested for other budget categories, including incentives. Moreover, the program has unusually complex technological requirements and is experiencing

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14. Staff has recommended that the increase to the overall budget be approved, but that payments to the Implementation Contractor not exceed 21 percent of the Existing Facilities program budget, and that amounts over 21 percent of the proposed total budget be shifted from the IC category to incentives. (This would mean that, in the budget table above, the proposed budget amount under "Implementation Contractor Services" would be reduced from $550,000 to $444,514, and the budget amount under "Incentives" would be increased from $1,270,041 to $1,375,527.) The 21 percent cap would also provide a limit going forward.

15. *Bill Impacts*. The requested budget increase, projected kWh sales, per-kWh increment and average summer and winter Residential bill annual impacts are listed below:

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16. The bill impacts shown above reflect a full year of the proposed increase to the Existing Facilities program budget. The current DSM adjustor rate (which is not altered in this matter), was approved in Decision No. 71720 on June 3, 2010, and includes 80 percent of the proposed budget increase, based on the program's high participation rate since inception. (Any over- or under-collections relative to spending for the overall DSM portfolio will be taken into account and trued up during the next adjustor reset.)

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[5] In 2009, 22.4% of total program spending went to Program Implementation, a category which includes direct program delivery costs, including implementation contractor labor and overhead costs. (See Table 2 of the semi-annual DSM report for TEP, for January through December 2009.)

17. *Reporting Requirements*. In addition to the existing reporting requirements, Staff has recommended that TEP's semi-annual DSM report, or any succeeding report ordered by the Commission, include a section which lists how much is paid to the IC, by program and in total.

CONCLUSIONS OF LAW

1. TEP is an Arizona public service corporation within the meaning of Article XV, Section 2, of the Arizona Constitution.

2. The Commission has jurisdiction over TEP and over the subject matter of the application.

3. The Commission, having reviewed the application and Staff's Memorandum dated July 7, 2010 concludes that it is in the public interest to approve an increase in the overall budget for the Existing Facilities program.

ORDER

IT IS THEREFORE ORDERED that the increase in the overall budget for the Tucson Electric Power Company's Existing Facilities program be approved, but that payments to the Implementation Contractor not exceed 21 percent of the Existing Facilities overall program budget.

IT IS THEREFORE ORDERED that the HVAC measures continue to be eligible for incentives as part of the Tucson Electric Power Company's Non-Residential Existing Facilities program.

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IT IS FURTHER ORDERED that Tucson Electric Power Company's semi-annual DSM report, or any succeeding report ordered by the Commission, include a section which lists how much is paid to the IC, by program and in total.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN COMMISSIONER

COMMISSIONER COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, ERNEST G. JOHNSON, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this _______day of ___________________, 2010.

ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

DISSENT: ____________________________

DISSENT: ____________________________

SMO:JMK:lhm\RM

SERVICE LIST FOR: Tucson Electric Power Company
DOCKET NO. E-01933A-07-0401

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